IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 76-1085

TELEPHONE ANSWERING SERVICE CO., INC.,
(Subsidiary Companies:
TELEPHONE ANSWERING SERVICE, INC.,
NORTH AMERICAN ANSWERING SERVICE, INC.,
TELEPHONE AND RADIO ANSWERING SERVICE COMPANY, INC.,
(MARYLAND), AND
TELEPHONE AND RADIO ANSWERING SERVICE COMPANY, INC.,
(TEXAS)),

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JOHN S. McDANIEL, JR.,
CALHOUN BOND,
LAWRENCE A. KAUFMAN,
915 Blaustein Building,
Baltimore, Maryland 21201,
Attorneys for Petitioners-Appellants.

Of Counsel:
CABLE, McDANIEL, BOWIE
& BOND,
915 Blaustein Building,
Baltimore, Maryland 21201.

The Daily Record Co., Baltimore, Md. 21202

INDEX

	PAGE
OPINIONS BELOW	1
JURISDICTION	2
QUESTION PRESENTED	2
STATUTE INVOLVED	3
STATEMENT OF THE CASE	3
REASONS FOR GRANTING WRIT:	
I. THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT DIRECTLY CONFLICTS WITH DECISIONS OF THE COURTS OF APPEALS FOR THE SECOND AND NINTH CIRCUITS	6
II. THE PROPER DISPOSITION OF THIS CASE INVOLVES AN IMPORTANT QUESTION OF LAW WHICH SHOULD BE SETTLED BY THIS COURT	10
CONCLUSION	12

CITATIONS

CASES:	PAGE
Berghash, et al. v. Commissioner, 43 T.C. 743 (1965)	8
Breech, et al. v. United States, 439 F.2d 409 (C.C.A. 9, 1971)	6, 7, 9
Commissioner v. Berghash, et al., 361 F.2d 257 (C.C.A. 2, 1966)	6, 7, 8, 9
Pridemark, Inc. v. Commissioner, 345 F.2d 35 (C.C.A. 4, 1965)	8, 9

PAGE

STATUTES:

United States Code
Title 26
Sec. 337(a) 3, 6, 7, 8, 9, 10, 11
Sec. 354 ..... 6, 7, 8, 9
Sec. 368(a)(1)(D) 6, 7, 8, 9
Title 28
Sec. 1254(1) 2

OTHER AUTHORITIES:

Report of House Ways and Means Committee, 1954 U.S. Code Congressional and Administrative News 782 6
Report of Senate Finance Committee, 1954 U.S. Code Congressional and Administrative News 2894 6

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No.

TELEPHONE ANSWERING SERVICE CO., INC.,
(Subsidiary Companies:
TELEPHONE ANSWERING SERVICE, INC.,
NORTH AMERICAN ANSWERING SERVICE, INC.,
TELEPHONE AND RADIO ANSWERING SERVICE COMPANY, INC.,
(MARYLAND), AND
TELEPHONE AND RADIO ANSWERING SERVICE COMPANY, INC.,
(TEXAS)),
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit finally entered in this proceeding on November 8, 1976.

OPINIONS BELOW

The opinion of the Tax Court is reported at 63 T.C. 423 (1975) and is reprinted in Appendix A hereto[1] at pp. 1a-21a.

[1] The separate Appendix to this petition is hereafter cited as "App.".

The decision of the Tax Court stating its deficiency determination was entered May 27, 1975 and is reprinted at App. B, pp. 22a-23a. The opinion of the Court of Appeals, which is not officially reported, is reprinted at App. C, pp. 24a-25a.

JURISDICTION

The judgment of the Court of Appeals was entered on November 8, 1976, and this petition for certiorari is filed within 90 days of that date. Jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTION PRESENTED

Prior to adoption of the Internal Revenue Code of 1954 this Court had held, in response to efforts by the Internal Revenue Service to collect the maximum amount of income taxes, that if a corporation sold assets and then liquidated, the corporation was taxable on the gain realized from the sale and the stockholders were taxable on the gain from the liquidation, but that if the corporation was liquidated and the assets were sold after liquidation, the corporation was not subject to any tax. Although this Court was of the opinion that a "distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial" and that there were "oddities in tax consequences", it deemed these to have been mandated by Congress. In an effort to remove the uncertainties which had arisen and establish a "definitive rule", Congress, when it enacted the Internal Revenue Code of 1954, specifically provided that no taxes should be imposed on gains realized by corporations from sales of assets if such sales were made after the corporation had adopted a plan of liquidation and the corporation distributed all of its assets to its stockholders in complete liquidation within 12 months after adopting the plan.

The question presented is whether a corporation which has in fact been dissolved and completely liquidated should be deemed not to have been completely liquidated solely because in effecting the liquidation it transferred a part of its assets to another corporation and distributed the stock of such other corporation to its stockholders.

STATUTE INVOLVED

The statute involved in this case is Section 337(a) of the Internal Revenue Code of 1954 (26 U.S.C. Sec. 337(a)), which provides:

"(a) GENERAL RULE.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

STATEMENT OF THE CASE

This case involves an alleged deficiency in Federal income tax of $70,566.46. The Court of Appeals affirmed *per curiam* the Tax Court's deficiency determination.

The sole disputed issue presented to the Tax Court was whether Telephone Answering Service Co., Inc. (hereafter "Tasco") distributed all of its assets to its stockholders in complete liquidation.[2] The parties and the Courts below agreed that the resolution of this issue was dependent upon the legal consequences of Tasco's actions in transferring a part of its assets to another

[2] Although the case originally involved several other issues, these were all settled prior to trial.

corporation and distributing the stock of such corporation to its stockholders instead of transferring such part of its assets directly to its stockholders.

Tasco was engaged in the telephone answering service business in various parts of the United States. Although a small part of its business activities was conducted directly by it, most of the business was carried on by two wholly-owned subsidiaries — Telephone Answering Service, Inc. (hereafter "Houston") and North American Answering Service, Inc. (hereafter "North American"). Tasco and its subsidiaries filed consolidated income tax returns. Tasco provided the management for the subsidiaries, which paid it management fees. In addition to owning all of the stock of the subsidiaries Tasco also held debt of the subsidiaries.

Tasco received an offer from General Waterworks Corporation to acquire all of the stock and debt of Houston owned by Tasco for a total consideration of $723,675, all of which was to be paid in cash. Tasco desired to accept this offer and adopted a Plan of Complete Liquidation and Dissolution which specifically authorized the sale of the Houston stock and debt to General Waterworks Corporation, generally authorized sales of any other assets and directed that Tasco be dissolved and liquidated and that all of its assets remaining after providing for its liabilities be distributed to its stockholders in complete cancellation and redemption of Tasco's stock. The Plan authorized the Directors of Tasco to transfer any assets of Tasco to one or more wholly-owned subsidiaries and to distribute the stock of said subsidiaries to the Tasco stockholders in effecting the liquidation.

Following the adoption of the Plan of Complete Liquidation and Dissolution, Tasco entered into an agreement with General Waterworks Corporation for the sale of the Houston stock and debt in accordance with

the offer. This agreement was performed in due course and Tasco received the entire consideration in cash. As a result of this sale Tasco realized a gain of $268,994.85. No other assets of the enterprise were sold with the exception of one of the telephone answering services which was operated by North American and which it sold to a minority stockholder of Tasco.[3]

Following the sale of the Houston stock and debt and the receipt of the entire consideration, Tasco transferred all of its assets other than the North American stock and $722,712.50 cash to another wholly-owned subsidiary (hereafter "New Tasco") in exchange for shares of New Tasco stock and Tasco then proceeded to liquidate by distributing all of the North American and New Tasco stock plus the $722,712.50 cash to the Tasco stockholders in complete cancellation and redemption of the Tasco stock. This distribution was made at the rate of one share of North American stock, one share of New Tasco stock and $8.50 cash for each share of Tasco stock. In connection with this distribution the Tasco stockholders were informed by Tasco that each share of New Tasco stock had a value of $1.50, that each share of North American stock had a value of $2.50 and that the amount by which the total distribution of $12.50 per share exceeded the stockholder's basis for the Tasco stock would be taxable as a capital gain.

The Tax Court held that Tasco was not completely liquidated since "substantially the same shareholders continue to utilize a substantial part of the directly owned assets of the same enterprise in uninterrupted corporate form." The Court of Appeals affirmed for the reason that "operations [of Tasco] were continued without interruption by a corporation organized at the time of the sale for the benefit of shareholders virtually identical to TASCO's."

[3] The tax consequences of this sale are not involved in the present case.

REASONS FOR GRANTING WRIT

The Court of Appeals' decision conflicts squarely with decisions of the Courts of Appeals for the Second and Ninth Circuits. *Commissioner v. Berghash, et al.*, 361 F.2d 257 (C.C.A. 2, 1966) and *Breech, et al. v. United States*, 439 F.2d 409 (C.C.A. 9, 1971).

The decision of the Fourth Circuit and the conflicting decisions of the Second and Ninth Circuits involve an important area of law as to which this Court has not directly addressed itself and which should be settled by this Court.

I.

THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT DIRECTLY CONFLICTS WITH DECISIONS OF THE COURTS OF APPEALS FOR THE SECOND AND NINTH CIRCUITS.

Although the purpose of the Congress in adopting Section 337 of the Internal Revenue Code was to adopt a "definitive rule which will eliminate the present uncertainties",[4] it was not entirely successful, since the Government almost immediately began contending that Section 337 was not applicable in all instances, notwithstanding that the selling corporation had been dissolved and had distributed all of its assets. In some instances these contentions were based on the propositions that (a) the dissolution and distribution of assets were merely steps in a reorganization meeting the requirements of Sections 354 and 368(a)(1)(D) of the Internal Revenue Code of 1954 (26 U.S.C. Secs. 354 and 368(a)(1)(D)[5] and (b) the Federal income tax consequen-

[4] Reports of House Ways and Means Committee and Senate Finance Committee, 1954 U.S. Code Congressional and Administrative News 782 and 2894.

[5] Briefly summarized, these sections require a transfer by one corporation of substantially all of its assets to another corporation and the distribution to the stockholders of the first corporation of all of the stock, securities and property received by the first corporation for the transfer.

ces, both to the selling corporation and to its stockholders, should be governed by the provisions of the Internal Revenue Code dealing with reorganizations rather than those, such as Section 337, dealing with liquidations. In other instances these contentions were based on the so-called liquidation-reincorporation or corporate solution theory that even though were was no reorganization, there was no "complete liquidation" for the purposes of Section 337 because following the completion of the entire transaction assets of the selling corporation were held by another corporation controlled by the same stockholders.

The Courts held with substantial unanimity that where the transaction as a whole met the requirements of Sections 354 and 368(a)(1)(D), Section 337 was not applicable to a sale of assets by one of the corporations which was a party to the reorganization, notwithstanding that as a part of the reorganization such selling corporation was dissolved and distributed all of its assets in complete liquidation. On the other hand, prior to the decisions of the Tax Court and of the Court of Appeals in the present case, no Court had held that Section 337 should not be applied to sales by a corporation merely because following the liquidation of the selling corporation some of its assets were held by another corporation controlled by the same stockholders and the Courts of Appeals for the Second and Ninth Circuits had expressly held to the contrary. *Commissioner v. Berghash, et al., supra; Breech, et al. v. United States, supra.*

Commissioner v. Berghash, et al., involved a sale by Delavan-Bailey Drug Co., Inc. of all of its operating assets to another corporation in exchange for 50% of its stock and a note. The other remaining 50% of the stock of the other corporation was owned by an unrelated person. Following the sale, Delavan-Bailey was dissolved and all of its assets (including the 50% of the stock of the buying corporation and the note of the

buying corporation) were distributed to Delavan-Bailey's stockholders. In the Tax Court the Government contended both that the transaction constituted a reorganization meeting the requirements of Sections 354 and 368(a)(1)(D) and that in any event Section 337 was not applicable to the sale because it "can apply only where a bona fide termination of the business of the liquidating corporation has occurred". *Berghash, et al. v. Commissioner,* 43 T.C. 743 at 758 (1965). The Tax Court rejected both contentions, holding that there was no reorganization because the Delavan-Bailey stockholders ended up holding only 50% of the stock of the buying corporation instead of the requisite 80% and that the continuation of the business in corporate form did not prevent the application of Section 337 to the gain which had been realized by Delavan-Bailey from the sale of assets. The Court of Appeals for the Second Circuit affirmed on both points, stating 361 F.2d at 260:

> "The only point upon which we see any need to expand upon the Tax Court's decision is the Commissioner's argument that, if the business of the liquidated corporation is continued by the new corporation, there is no 'complete liquidation.' * * * We are in complete agreement with the Tax Court's resolution of this issue; its interpretation reflects the normal meaning of the words 'complete liquidation' in sections 331 and 337. To adopt the Commissioner's contention would do violence to the plain meaning of these statutes."

Significantly, the Court of Appeals for the Second Circuit noted that the only authority for the Commissioner's contention was dictum in the decision of the Court of Appeals for the Fourth Circuit in *Pridemark, Inc. v. Commissioner,* 345 F.2d 35 at 41 (C.C.A. 4, 1965).[6]

[6] In *Pridemark, Inc.,* the Court of Appeals for the Fourth Circuit found that although the selling corporation transferred assets to another corporation which was controlled by the same stockholders, there was no continuation of the business and, therefore, Section 337 was applicable to the sale.

Breech, et al. v. United States, supra involved a sale by Valley Ford Sales ("Valley-1") to Valley Ford Sales ("Valley-2"). 20% of the stock of Valley-2 was owned directly by a stockholder of Valley-1. The remaining 80% of the stock of Valley-2 was owned by another corporation, 75% of the stock of which was owned by other stockholders of Valley-1. The Court of Appeals for the Ninth Circuit rejected the contentions of the Government that the transaction was a reorganization meeting the requirements of Section 354 and 368(a)(1)(D), holding that the indirect holdings in Valley-2 by some of Valley-1's stockholders could not be combined with the direct holding in Valley-2 by another of Valley-1's stockholders for the purpose of meeting the 80% requirement. The Court of Appeals also expressly rejected the Government's contention that

> "the liquidation of Valley-1 cannot qualify as a 'complete liquidation' within the meaning of Section 331 and 337 because the assets of Valley remained in corporate solution under the effective control of the same taxpayers who controlled Valley-1 even though Valley-1 was completely dissolved under California law." 439 F.2d at 410.

Significantly, the Court of Appeals for the Ninth Circuit also expressly refused to follow the dictum of the Court of Appeals for the Fourth Circuit in *Pridemark, Inc. v. Commissioner, supra* and elected to follow the decision of the Court of Appeals for the Second Circuit in *Commissioner v. Berghash, et al., supra.*

The Court below, in affirming the Tax Court, placed itself squarely in opposition to the Second and Ninth Circuits. Although the Government had contended in the Tax Court that the transfer of assets by Tasco to New Tasco constituted a reorganization meeting the requirements of Sections 354 and 368(a)(1)(D), the Tax Court did not reach that issue. See Footnote 4 to its Opinion, 63 T.C. at 432 (App. 13a). Instead, it held that Section 337 is not applicable to the sale of the Houston

stock and debt solely because "the same shareholders continue to utilize a substantial part of the directly owned assets of the same enterprise in uninterrupted corporate form", 63 T.C. at 433 (App. 14a), and the liquidation of Tasco did not effect "a sufficient transmutation of the assets of petitioner out of corporate solution to satisfy the requirement of section 337 that 'all of the assets of the corporation' be distributed." 63 T.C. at 435 (App. 16a). These holdings were adopted *in toto* by the Court of Appeals for the Fourth Circuit when it stated that "We are content to rest decision on the Tax Court's opinion". (App. 25a).

II.

THE PROPER DISPOSITION OF THIS CASE INVOLVES AN IMPORTANT QUESTION OF LAW WHICH SHOULD BE SETTLED BY THIS COURT.

As indicated *supra,* the purpose of Congress in enacting Section 337 was to adopt a "definitive rule which will eliminate the present uncertainties". The effect of the decision of the Court of Appeals for the Fourth Circuit in the present case is to raise new uncertainties. See the comments by Judge Sterrett in his dissenting opinion, 63 T.C. at 438 (App. 20a).

It would appear from Footnote 9 to the Tax Court's opinion, 63 T.C. at 436 (App. 17a), that if Tasco's business had been conducted entirely through three subsidiaries, it had sold the stock and debt of one such subsidiary and had then dissolved and distributed the stock of the other two subsidiaries, Section 337 would have precluded the imposition of any tax on the gain realized from the sale of the stock and debt. On the other hand, it would appear that if all of the answering services had been directly operated by Tasco, it desired to dispose of one part of its business and split up the balance into two separate corporations and in order to accomplish this, it transferred different parts of its

assets to three subsidiaries, sold one such subsidiary and distributed the stock of the other two subsidiaries pro rata to the Tasco stockholders, the gain from the sale would be taxable since each of the two distributed subsidiaries would continue to utilize a substantial part of Tasco's assets and continue operation of businesses which had been conducted by Tasco.

It is a matter of common knowledge that some business enterprises are conducted entirely by a single corporation, that other exactly similar enterprises are conducted in part directly by a parent corporation and in part by subsidiaries and that still others are conducted entirely through subsidiaries. It is difficult to believe that in enacting Section 337 the Congress intended to effect an exaltation of form over substance and to require different tax consequences where an enterprise is liquidated, a part of its business is sold and the remaining parts are divided between two separate continuing corporations depending purely upon whether or not some part of the activities of the enterprise had been directly conducted by a parent corporation and other parts had been conducted by subsidiaries, yet this is exactly what the Court of Appeals for the Fourth Circuit has found was intended.

Although many of the Courts of Appeals and other lower Courts have had occasion to consider so-called liquidation-reincorporation transactions and, until the decision in the present case, have uniformly held that unless there is a reorganization, the transfer of some of the assets of the liquidating corporation to a continuing corporation does not affect the completeness of the liquidation, this Court has never had occasion to consider this particular issue.

CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

JOHN S. MCDANIEL, JR.,
CALHOUN BOND,
LAWRENCE A. KAUFMAN,
915 Blaustein Building,
Baltimore, Maryland 21201,
Attorneys for Petitioners-Appellants.

Of Counsel:
CABLE, MCDANIEL, BOWIE & BOND,
915 Blaustein Building,
Baltimore, Maryland 21201.